

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

77-6114

To be argued by
DAVID C. TOOMEY

In The

United States Court of Appeals

For The Second Circuit

FRIENDSHIP DAIRIES, INC., POLLIO DAIRY
PRODUCTS CORP., CROWLEY FOODS, INC.,
QUEENSBORO FARM PRODUCTS INC., SARATOGA
DAIRY, INC., DELTOWN FOODS, INC., ELMHURST
MILK AND CREAM CO., INC., QUEENS FARMS, INC.,
and CUBA CHEESE AND TRADING CO., INC.,

Plaintiffs-Appellants,

-against-

EARL BUTZ, Secretary of the Department of Agriculture of the
United States,

Defendant-Appellee.

-and-

PENNMARVA DAIRYMEN'S COOPERATIVE
FEDERATION, INC.,

Intervenor-Appellee.

*From an Order and Judgment of the United States District
Court for the Eastern District of New York in 75c 1517.*

BRIEF FOR PLAINTIFFS-APPELLANTS

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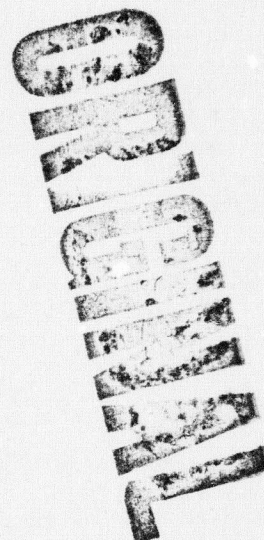
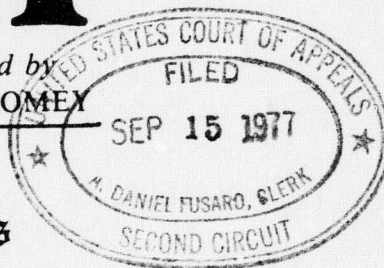


TABLE OF CONTENTS

Table of Contents.....	i
Table of Citations.....	ii
The Decision Below.....	1
Statement of the Issue Presented for Review.....	2
Statement of the Case.....	3
A. Nature of the Case and Its Disposition Below.....	3
B. Statement of Facts.....	4
1. The Operation of the Marketing Order System, and Material Provisions in the Order.....	5
2. The Administrative Hearing.....	9
3. The Administrative Appeals, and the Appeal to the District Court.....	17
Argument.....	19
I. The District Court Erred in Holding that the Secretary's Order Was Supported by Substantial Evidence: No Evidence Was Produced to Support the Validity or Use of the M-W Series as the Only Basis For Pricing Milk.....	19
A. Summary.....	19
B. Information Privately Held by the Secretary Cannot be the Basis of Legal Agency Action.....	21
1. The Substantial Evidence Rule Requires That an Order Be Based Upon Evidence on the Record.....	21
2. There Was No Evidence to Support the Order.....	22
Conclusion.....	32

TABLE OF CITATIONS

I. CASES

<u>Abbotts Dairies Division of Fairmont Foods, Inc.</u> <u>v. Butz</u> , 389 F. Supp. 1 (E.D. Pa. 1975).....	27,30
<u>Abbotts Dairies Division of Fairmont Foods, Inc.</u> <u>v. Hardin</u> , 351 F. Supp. 561 (E.D. Pa. 1972).....	27
<u>Baltimore & Ohio R. Co. v. Aberdeen & R.R. Co.</u> , 393 U.S. 87, 89 S.Ct. 280 (1968), <u>reh. denied</u> , 393 U.S. 1124 (1969).....	26
<u>Blair v. Freeman</u> , 370 F.2d 229 (D.C. Cir. 1966).....	25
<u>Brannan v. Stark</u> , 342 U.S. 451, 72 S.Ct. 433 (1952).....	25
<u>Consolo v. Federal Maritime Commission</u> , 383 U.S. 607, 86 S.Ct. 1018 (1966).....	22
<u>Crowley's Foods, Inc., et al v. Butz</u> , C.A. No. 74-516 (D.D.C.).....	17
<u>Edison Co. v. Labor Board</u> , 305 U.S. 197, 59 S.Ct. 206 (1938).....	22
<u>Fairmont Foods Co. v. Hardin</u> , 442 F.2d 762 (D.C. Cir. 1971).....	22,27,29
<u>Friendship Dairies, Inc. et al v. Butz</u> , 432 F. Supp. 508 (1977).....	1
<u>George Benz and Sons v. Hardin</u> , 342 F. Supp. 88 (D. Minn. 1972).....	22
<u>Goldberg v. Kelly</u> , 397 U.S. 254 (1970).....	22
<u>Grant v. Benson</u> , 229 F.2d 765 (D.C. Cir. 1955), <u>cert. den.</u> 350 U.S. 1015 (1956).....	6
<u>Greater Boston Television Corp. v. FCC</u> , 444 F.2d 841 (D.C. Cir. 1970), <u>cert. denied</u> , 403 U.S. 923 (1971).....	27

<u>Harry H. Price & Sons, Inc. v. Hardin</u> , 425 F.2d 1137 (5th Cir. 1970), <u>cert. den'd</u> , 400 U.S. 1009 (1971).....	5
<u>Midwest Milk Monopolization Litigation</u> , JPML No. 83.....	16,24
<u>Morgan v. United States</u> , 298 U.S. 468, 56 S.Ct. 906 (1936).....	31
<u>Ohio Bell Tel. Co. v. Comm'n</u> , 301 U.S. 292 (1937).....	22
<u>United States v. AMPI</u> , W.D. Mo. No. 74-CV80-W-1, 380 F. Supp. 880 (W.D. Mo. 1974).....	16
<u>United States v. Ruzicka</u> , 329 U.S. 287 (1946).....	17
<u>Zuber v. Allen</u> , 396 U.S. 168, 90 S.Ct. 314 (1969)....	25,29,30

II. STATUTES AND RULES

28 U.S.C. §1291.....	3
5 U.S.C.A. §551 <u>et seq.</u>	4,10
5 U.S.C.A. §706.....	22
7 U.S.C.A. §601 <u>et seq.</u>	3
7 U.S.C.A. §602.....	5
7 U.S.C.A. §608c (3).....	21
7 U.S.C.A. §608c (4).....	21
7 U.S.C.A. §608c (5) (A).....	13
7 U.S.C.A. §608c (11) (A).....	5,13
7 U.S.C.A. §608c (11) (C).....	5,13
7 U.S.C.A. §608c (15) (A).....	17
7 U.S.C.A. §608c (15) (B).....	3,18,32
7 U.S.C.A. §608c (17).....	21
7 C.F.R. §900.65 (a).....	18

7 C.F.R. §1002.....	3
7 C.F.R. §1002.3.....	5
7 C.F.R. §1002.50a.....	6
7 C.F.R. §1002.6.....	4
7 C.F.R. §1002.7.....	4
7 C.F.R. §1002.8(b).....	4
7 C.F.R. §1002.83 <u>et seq.</u>	7
7 C.F.R. §1002.90.....	12

III. MISCELLANEOUS

K. Davis, <u>Administrative Law</u> , §29.01 (Supplement 1970).....	22
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THE DECISION BELOW

This appeal is from an Order granting summary judgment against the Defendant, and dismissing the Complaint. The decision was rendered by the Honorable Edward R. Neaher of the United States District Court for the Eastern District of New York. It is reported at 432 F. Supp. 508.

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Where the Secretary of Agriculture adopted a secret economic formula as the sole determinant of the price which manufacturers of milk products should pay for their milk, after a rule making "hearing" in which he refused to produce any evidence related to the formula, despite Appellants' request, did the Court below err in holding that the Order was supported by substantial evidence?

STATEMENT OF THE CASE

A. Nature of the Case and Its Disposition Below.

The Appellants in this matter are manufacturers of dairy products, such as ice cream, cottage cheese and cheese, who are located within the State of New York. The minimum prices which the Appellants must pay farmers for raw milk are established by the Secretary of Agriculture in a Milk Marketing Order known as "Order No. 2" (7 C.F.R. §1002), promulgated under the Agricultural Marketing Agreements Act of 1937, 7 U.S.C.A. §601 et seq. ("the Act").

In this case, Appellants -- after exhausting their administrative remedies -- appealed to the District Court under Section 15(B) of the Act (7 U.S.C.A. §608c(15)(B)), seeking reversal of a decision by the Secretary which amended Order No. 2 by establishing a secret economic formula known as the "Minnesota-Wisconsin Series" as the sole basis for determining the price which manufacturers of milk products must pay for milk. The District Court granted the Secretary's Motion for Summary Judgment and dismissed the Complaint.

Appellants have now appealed to Your Honorable Court pursuant to 28 U.S.C. §1291. Appellants contend that, since the Secretary refused to produce any evidence respecting the nature of the Minnesota-Wisconsin Series, or the details

concerning it at the rule-making "hearing" which resulted in the Order, despite repeated Motions and requests that he do so, and since they were therefore denied the opportunity to cross-examine persons knowledgeable about the Series to test its validity and applicability, it was illegal for the Secretary to adopt the Series as the determinant of the minimum prices they must pay, under both the Agricultural Marketing Agreements Act and the Administrative Procedure Act, 5 U.S.C.A. §551 et seq.

B. Statement of Facts.

As indicated above, the provisions of the Agricultural Marketing Agreements Act have been implemented by the issuance of regional Milk Marketing Orders by the successive Secretaries of Agriculture. These Orders determine the minimum price which "handlers" of milk must pay for raw milk, and correspondingly, the amount which dairy farmers, who are called "producers", will receive. In essence, a "handler" is a person who receives raw unprocessed milk from a "producer", and either processes it into fluid milk or uses it to "manufacture" dairy products.¹

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1. The precise definition of a "producer" and a "handler" appear at 7 C.F.R. §§1002.6 and 1002.7 respectively.

Technically, two of the Appellants -- Cuba Cheese Company and Pollio Dairy Products Corporation -- are not "handlers" because they do not operate "pool plants" as defined in 7 C.F.R. §1002.8(b). However, the price which those companies pay for milk is in fact determined by the Order, and the Court below correctly found that they had standing to join in this case because they were adversely affected

Before describing the events which led to the Order Amendment which is involved in this case, we will briefly outline the manner in which the Marketing Order operates. We will then set forth the facts which bear upon this particular case.

1. The Operation of the Marketing Order System, and Material Provisions in the Order.

The Agricultural Marketing Agreements Act empowers the Secretary of Agriculture, inter alia, to establish the minimum prices which "handlers" must pay to "producers" for their milk: 7 U.S.C.A. §602. The Act provides that the prices established by the Secretary shall be uniform, subject to variations for regional differences in local marketing conditions: 7 U.S.C.A. §§608c(11)(A) and (C).

The device used by the Secretary to carry out this duty has been the issuance of regional Marketing Orders. Order No. 2, which is the Order involved in this case, covers the Eastern half of New York State and Northern New Jersey: 7 C.F.R. §1002.3.

(Footnote 1 Continued)
by the Secretary's action (1457a). See Harry H. Price & Sons, Inc. v. Hardin, 425 F.2d 1137 (5th Cir. 1970), cert. den'd 400 U.S. 1009 (1971).

For purposes of this Brief, these Appellants will therefore be referred to collectively with the other Appellants as "handlers".

Under the Marketing Orders, the Secretary has established different minimum prices which handlers must pay for raw milk, depending upon the end-use to which the milk is put: 7 C.F.R. §1002.50a. Generally speaking, milk which is bottled and sold as a fluid product (such as whole milk, skim milk, chocolate milk, etc.) is referred to as "Class I" milk.² Under this Order,³ milk which is processed into food products (such as ice cream, cottage cheese, cheddar cheese, etc.), is referred to as "Class II", or "manufacturing" milk. Because the price established for "Class I" milk is always substantially higher than the price for "Class II" milk, "Class II" milk is also referred to in the industry as "surplus" or "reserve" milk.

As indicated, handlers pay for their milk according to the use to which they put it. The actual mechanics of this process are somewhat complicated;⁴ it may be described by the following schematic. Instead of paying the farmers directly, the handlers pay the money to the Department of Agriculture's Market Administrator, who places the money in a fund known variously as the "producer settlement fund" or the "equalization

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2. In Order No. 2, Class I milk is broken down into two sub-classifications, I-A and I-B. These sub-classifications are irrelevant to this proceeding.
 3. Other Orders have additional classifications, which are not material here.
 4. They are described in Grant v. Benson, 229 F.2d 765 (D.C. Cir. 1955), cert. den. 350 U.S. 1015 (1956).

pool".⁵ Out of that "fund" or "pool", the farmers are then paid a "blend price" which is somewhere between the Class I price and the Class II price in accordance with the "marketwide utilization"; i.e., the percentage which receipts from Class I purchases have to the total amount paid by handlers.

While this may sound complicated, it is essentially a simple process: if one assumes a market in which one farmer sells one hundredweight of milk to a handler which is used for fluid milk (Class I), and one other farmer sells one hundredweight of milk to a handler which is used for manufacturing (Class II), the "marketwide utilization" is 50%. If the Class I price were \$10.00 per hundredweight, and the Class II price were \$8.00, the total amount paid into the pool would be \$18.00, and each farmer would be paid \$9.00 from the Producer Settlement Fund for his sales. The \$9.00 is referred to as "the blend", or "the blend price":

<u>1 cwt. at \$10.00</u>	:	
Class I	:	
	:	\$18.00 ÷ 50% = \$9.00 to
	:	each farmer
<u>1 cwt. at \$ 8.00</u>	:	
Class II	:	

The amendment which is attacked in this case changed the method used to establish the Class II price, i.e.,

5. See 7 C.F.R. §1002.83 et seq.

the price which "handlers" must pay for milk to be manufactured into food products.

Prior to the Amendment which is involved here, the Class II price was established by the Secretary by using two alternative formulas: (1) the "basic formula price", otherwise known as the Minnesota-Wisconsin Series (hereafter the "M-W Series"); or (2) the "Butter-Powder formula". Until the 1974 Amendments, the Class II price was the lower price which the two alternative formulas produced.

The "M-W Series" is a formula whose components are held secret by the U.S.D.A., but which is said to be an average of the actual prices paid for milk by selected cheese plants in Minnesota and Wisconsin.

The "Butter-Powder" formula is a mathematical formula based upon the public prices paid for butter and dry skim milk ("powder") on the Chicago commodities exchanges.

The reason for these alternatives has been that most manufactured milk products can be made either out of milk, or by blending butter and powder with water to make reconstituted milk; therefore, manufacturers of milk products will presumably use either milk or butter and powder, whichever is cheaper.

Over the years, these two formulas have produced pay prices which have been reasonably close to each other. However, beginning in October 1973, largely as the result of

Government export policies with respect to feed grains, Government import policies respecting dairy products, and the effect of Government-established price support levels, the M-W Series formula began to produce a price increasingly larger than the butter-powder formula did, causing the butter-powder formula to become the determinant of Class II prices.

Although the "blend prices" which farmers in the New York-New Jersey area were getting for milk had increased 49% in Order 2 from December 1972 to December 1973, and had also increased substantially in all other Orders in the Northeast (637a-638a), various farmer organizations saw the opportunity to further increase the "blend prices"--i.e., their members "take-home pay"--by removing the butter-powder formula as an alternative pricing mechanism for manufacturing milk. They therefore requested the Secretary to hold a hearing to accomplish that objective.

2. The Administrative Hearing

As a consequence of the requests from the farmer organizations, the Secretary issued a Notice of Hearing dated February 12, 1974 (2a-8a), which was published in the Federal Register on February 14, and announced the commencement of a hearing on February 20--only six days later-- at which would be considered the establishment of the M-W Series as the sole basis for pricing manufacturing milk in eight Northeastern Orders.

Despite the fact that the vast majority of farmer organizations, although desiring ultimate removal of the butter-powder formula, denied the existence of any emergency which would justify deviation from the usual decision-making procedures required by the Department Regulations and the Administrative Procedure Act, 5 U.S.C.A. §551 et seq. (266a, 290a, 304a, 428a-429a, 563a, 565a-566a, 604a), the hearing proceeded on an "emergency" basis.

In fact, of the many farmer groups who appeared, only two-- National Farmers Organization (NFO) and Pennmarva, neither of which has any significant dealings in the New York-New Jersey area -- claimed that there was an "emergency." And that "emergency" was caused, according to those groups, not by ordinary economic events, but by action of the Government itself with respect to export and import policies, and the level of 1973 support prices (17a, 152a-153a, 252a-264a).

The proposals to eliminate the "butter powder formula" as a method for pricing manufacturing milk necessarily implied that, if accepted, the so-called Minnesota-Wisconsin Series would become the sole basis upon which the minimum price of manufacturing milk would be established.

As was indicated previously, the Minnesota-Wisconsin Series is a secret formula whose details are known only to the Department of Agriculture. It is said to be the average pay price which certain selected cheese plants located

in Minnesota and Wisconsin -- said to number from 110 to 300 plants -- pay for their milk (1223a). These plants are totally unregulated, and not subject to Governmental control, as are the Appellant's plants.

There had developed in the industry substantial doubt that the Minnesota-Wisconsin Series had any validity as a basis for pricing milk (348a, 573a-579a). Nonetheless, the Department had adhered to it, while steadfastly refusing to provide the details concerning it, including refusing to identify the plants which are included in the Series (1223a); it was (and is) believed, however, that many of the plants are owned by farmer cooperatives, who in effect are paying themselves for the milk. It was (and is) further believed that the cooperatives which own these plants also sell large amounts of milk to handlers regulated by Federal Orders. By charging themselves artificially high prices for milk used in their Minnesota and Wisconsin cheese plants, and then reporting those prices to the U.S.D.A., these cooperatives could succeed in rigging the Minnesota-Wisconsin Series, thereby reaping the profits from the artificially-enhanced prices which regulated handlers pay them for their other milk under the Federal Orders.

Furthermore, unrebutted testimony was presented that, whatever could be said for the integrity and validity of the M-W Series in the Midwest, the average pay price of unregulated plants in Minnesota and Wisconsin had no bearing

on the price which handlers in the Northeast should pay for milk. In fact, by requiring regulated handlers in the Northeast to pay to Northeast farmers for milk the same price as Minnesota-Wisconsin plants pay Midwest farmers, the Midwest plants are given a substantial competitive advantage over regulated plants in the Northeast, for several reasons.

First, because plants in Minnesota and Wisconsin are unregulated, they do not have to pay the 3-1/2 cents per hundred-weight assessment which Order No. 2 handlers must pay to finance the operations of the U.S.D.A. Market Administrator's office: 7 C.F.R. §1002.90.

Second, because they purchase milk F.O.B. plant, Minnesota and Wisconsin plants do not have to pay the cost of transporting milk from the farm. Order No. 2 handlers, on the other hand, must pay F.O.B. farm; the handling allowance they are allowed under the Order is not sufficient to cover the cost of transportation (308a, 338a).

And third, and perhaps most important of all, Minnesota and Wisconsin plants are able to obtain more product from their milk than are Northeast manufacturers due to a difference in the chemistry of the milk: M-W plants are able to get 1/2-3/4 of a pound more cheese out of a hundredweight of milk than are Northeast manufacturers (308a-310a). The result is that New York plants -- which processed 700 million pounds of milk into cheese in 1973 (311a) -- generate 65-67 cents less

revenue from 100 pounds of milk than do Minnesota and Wisconsin plants (315a). Assuming an equivalent amount of production in Minnesota and Wisconsin, the disadvantage in production cost due to yield differences alone (without regard to the assessments and hauling costs referred to above) is \$4.5 million.

Thus, since Minnesota and Wisconsin cheese plants market their products in the Northeast (1253a), immense competitive advantages accrue to Minnesota and Wisconsin manufacturers (who are, as indicated, largely farmer cooperatives) if the cost of milk is equalized between the areas.⁶

Because of the wide-spread belief that the Minnesota-Wisconsin Series was not a valid basis for determining prices, and because it was proposed to make the Minnesota-Wisconsin Series the sole basis for determining them, the Appellants in this case and other parties to the hearing repeatedly made Motions for the production of material which would either justify the validity and applicability of the Series' use, or permit opponents of its use to show its invalidity (142a-148a, 491a, 657a). The Administrative Law Judge ruled that he had no power to direct the Secretary to do something he didn't want to do, but that he would treat the

6. In this regard, see 7 U.S.C.A. §608c(5)(A), 608c(11)(A) and 608c(11)(C), requiring that all marketing orders must take into account regional marketing and production differences.

Motion as an on-the-record request to the Secretary (142a-148a).
No reply was made for several days.

When finally a response was made, the response was that the Secretary could not produce a witness qualified to testify about the M-W Series without at least two months of preparation (589a-591a). Mr. Palmer, responding for the Secretary, denied the requests for the following reasons:

"Number one, that a qualified employee is not available for immediate appearance."

"And secondly, to make the kind of study [as to the details of the M-W Series] they requested would require considerable amounts of hand-sorting data from monthly and annual reports for a large number of plants and preparation of the requested information and testimony, a witness for testimony, would entail a period of approximately two months." (591a).

It did develop at the hearing, moreover, that the Secretary makes absolutely no attempt to determine whether the pay prices which the Minnesota-Wisconsin plants are reporting, are in fact the prices which they are paying. Mr. Trelogan, of the U.S.D.A.'s Statistical Reporting Service, made the astounding admission that:

"We have no provision for verifying on a regular basis that the prices reported are actually paid." (589a).

Even those expert witnesses who testified for producer groups advocating the Minnesota-Wisconsin Series

admitted that they did not know the details of the Series (74a-75a, 175a, 300a-301a).

Since the only party having knowledge of the details of the M-W Series was unable to come forward to justify its validity, integrity, or applicability, the record is totally devoid of any testimony which would justify it as the sole determinant of milk costs.

Nonetheless, 19 days after the Hearing ended -- which was only five days less than the entire time which had been allowed from the Notice of Hearing to the Briefing deadline -- the Secretary announced on March 27, 1974 an "emergency" amendment to the Order to be effective six days later, which removed the butter-powder formula as an alternative method of pricing manufacturing milk until July 31, 1974 (1083a-1109a), and established the M-W Series as the sole basis on which the minimum price for milk would be set.⁷

On June 21, 1974, the Secretary, without taking any additional testimony, issued a Recommended Decision as to "long-term" pricing, i.e., pricing after July 31, 1974, which adopted the pricing scheme contained in the so-called "emergency"

7. Except for milk used in manufacturing butter and powder itself, as to which the butter-powder formula could be used so long as it did not result in a price more than 50 cents less than the price resulting from the M-W Series. This limited use of the butter-powder formula was eliminated in the "permanent" Order of July 25.

Order of March 27, and thereby made permanent the elimination of the butter-powder formula (1284a-1285a).

In the interim period between the "emergency" Order of March 27, 1974, and the "long-term" Order of July 25, 1974, the first proof to substantiate the suspicions about the M-W Series came from an unexpected source -- deposition testimony in an anti-trust case in Kansas City.

On May 31, 1974, Dwight Morris, a retired officer of Associated Milk Producers, Inc. (AMPI) -- the largest cooperative in the country with extensive manufacturing operations in Minnesota and Wisconsin -- admitted under oath that the M-W Series had, in fact, been rigged. At pp. 94-100 of his deposition in United States v. AMPI, W. D. Mo. No. 74-CV80-W-1, 380 F.Supp. 880 (W.D. Mo. 1974), (one of three cases also known as the Midwest Milk Monopolization Litigation, JPML No. 83), Morris testified that AMPI had overpaid its Minnesota-Wisconsin members five cents per hundredweight, reported those prices to the U.S.D.A., and thereby earned hundreds of millions of dollars for their farmers nation-wide (see attachment to Exceptions, incorporated by reference at Admin. Rec. Part I, Item 39, and Offer of Proof at 1227a-1237a.).

These Appellants brought the Morris testimony to the attention of the Secretary in the course of their administrative appeal, which was then pending, and argued that this illustrated the need to vacate the "temporary" Order then

in effect and defer a "long-term" Order until a proper hearing could be held at which full exploration could be given to the use of the Minnesota-Wisconsin Series as the sole basis for determining prices (1228a-1237a).

Nonetheless, an Order implementing the Recommended Decision was issued without further hearing on July 25, 1974 (1284a-1285a).

3. The Administrative Appeals, and the Appeal to the District Court

On April 8, 1974--promptly after the "emergency" amendment of March 24, 1974, had gone into effect--Appellants filed an administrative appeal under Section 15(A) of the Act, 7 U.S.C.A. §608c(15)(A).⁸ The hearing on their appeal was held on July 1, 1974, in Philadelphia, before Administrative Law Judge John Campbell (1168a-1283a). Since the Recommended Decision on "long-term" pricing after July 31 had been announced just prior to the hearing, and was to be implemented by Order

8. Appellants also filed an action in the United States District Court for the District of Columbia seeking a preliminary Injunction against implementation of the Order: Crowley's Foods, Inc., et al v. Butz, Civil Action No. 74-516. The Court, on April 18, 1974, denied Appellants a Preliminary Injunction, and refused to review the issues now presented in this Court on the ground that it had no jurisdiction to do so prior to Appellants' exhaustion of administrative remedies, under United States v. Ruzicka, 329 U.S. 287 (1946). The Complaint was subsequently dismissed for lack of jurisdiction under Ruzicka.

shortly thereafter, the Appellants filed an Amended Appeal Petition appealing that Order as well (Admin. Rec., Part I, Item 39). The parties then stipulated that the hearing record made on July 1, 1974, would apply to the "long-term" Order of July 25, 1974 as well as the "emergency" Order. (1284a-1285a).

On June 2, 1975, the Administrative Law Judge filed his Decision denying Plaintiffs' appeal (1286a-1343a). Appellants thereupon appealed directly to the Secretary pursuant to 7 C.F.R. §900.65(a) to reverse the Decision of the Administrative Law Judge (1344a-1346a). This appeal was denied on August 26, 1975 on behalf of the Secretary by the Department Judicial Officer (1347a-1353a).

Having exhausted their administrative remedies, the Appellants appealed to the District Court to secure the relief they had been denied by the Department, pursuant to 7 U.S.C.A. §608c(15)(B). The District Court held that there was substantial evidence in the Record to support the imposition of the M-W Series as the sole basis for pricing manufacturing milk.

We respectfully disagree with the Court below, and urge your Honorable Court to hold that there was no substantial evidence to support the Secretary's Order.

ARGUMENT

- I. The District Court Erred in Holding that the Secretary's Order Was Supported by Substantial Evidence; No Evidence Was Produced to Support the Validity or Use of the M-W Series as the Only Basis For Pricing Milk.

- A. Summary

We respectfully submit that there is no substantial evidence to support an Order when the only party having possession of the evidence related to the subject matter of the hearing refuses to produce it. In this case, it was proposed to impose the M-W Series upon all handlers subject to the Order, as the sole basis upon which the most crucial raw material they buy was to be priced. While there was conclusory evidence from farmer organization economists to the effect that the M-W Series was a good thing -- meaning that it produced more money for farmers -- these same persons confessed to know nothing about it (74a-75a, 175a, 300a-301a).

Thus, the Record in this case was totally bare of testimony regarding such questions as:

- ¶ What is the M-W Series?
- ¶ Is it in fact the average pay price of handlers in Minnesota and Wisconsin?
- ¶ How does it operate?
- ¶ Who supplies the data on which it is based?
- ¶ Is that data accurate?
- ¶ Is the result a fair and accurate method of pricing milk in New York and New Jersey?

It is one thing to find that farmers are having economic difficulties, and quite another thing to "solve", those difficulties by imposing a secret formula that no one except the Secretary knows anything about, no matter how laudable his objective to help the farmers may have been.

We submit that absent the opportunity to explore the validity of the M-W Series on the record, the Order imposing it was without substantial supporting evidence.

B. Information Privately Held by the Secretary Cannot
be the Basis of Legal Agency Action.

1. The Substantial Evidence Rule Requires That an
Order Be Based Upon Evidence on the Record.

The Agricultural Marketing Agreements Act provides at 7 U.S.C.A. §608c(3) and (4)⁹ that the promulgation of a marketing order requires findings, based "upon the evidence introduced at (a) hearing". Amendment proceedings must also be governed by hearing evidence: 7 U.S.C.A. §608c(17)¹⁰

This means that substantial evidence is required

9. "(3) Whenever the Secretary of Agriculture has reason to believe that the issuance of an order will tend to effectuate the declared policy of this chapter with respect to any commodity or products thereof specified in subsection (2) of this section, he shall give due notice of and an opportunity for a hearing upon a proposed order.

"(4) After such notice and opportunity for hearing, the Secretary of Agriculture shall issue an order if he finds, and sets forth in such order, upon the evidence introduced at such hearing (in addition to such other findings as may be specifically required by this section) that the issuance of such order and all of the terms and conditions thereof will tend to effectuate the declared policy of this chapter with respect to such commodity.

10. "(17) The provisions of this section and section 608d of this title applicable to orders shall be applicable to amendments to orders: Provided, that notice of a hearing upon a proposed amendment to any order issued pursuant to this section, given not less than three days prior to the date fixed for such hearing, shall be deemed due notice thereof."

to support a milk-pricing order. See Fairmont Foods Co. v. Hardin, 442 F.2d 762, 772 (D.C. Cir. 1971); George Benz and Sons v. Hardin, 342 F. Supp. 88, 89 (D. Minn. 1972).

Similarly, the Administrative Procedure Act provides that reviewing courts shall hold unlawful and set aside agency action which is found to be unsupported by substantial evidence: 5 U.S.C.A. §706. It is axiomatic that an Administrative Decision and Order must be based upon facts developed at the hearing, or else it violates the Due Process rights of those affected adversely by it: Goldberg v. Kelly, 397 U.S. 254, 264, 271 (1970); Ohio Bell Tel. Co. v. Comm'n, 301 U.S. 292, 300, 302-03 (1937).

Substantial evidence is relevant evidence that a reasonable person might accept to support a conclusion. Consolo v. Federal Maritime Commission, 383 U.S. 607, 619-20, 86 S.Ct. 1018, 1026 (1966). It is more than a mere scintilla. Edison Co. v. Labor Board, 305 U.S. 197, 229, 59 S.Ct. 206, 217 (1938). See K. Davis, Administrative Law, §29.01 at 996-97 (Supplement 1970). The rights which these rules of law afford are not satisfied when action is taken on the basis of information known solely to the administrative agency.

2. There Was No Evidence to Support the Order.

The issue at the rule-making hearing was whether a secret formula whose validity and integrity was widely

questioned should be made the sole basis upon which the handlers would be required to pay for their milk. In order to resolve that issue, an on-the-record analysis of the formula was needed. In basing its decision on the conclusion that the only issue was the removal of the butter-powder formula, and that the validity of the M-W Series was beyond the scope of the hearing (1466a), the Court below apparently misconceived the relationship between the two formulae, and thus the basic issue in the case.

Although it is true that the Secretary in the Notice of Hearing framed the issue as being whether to remove the butter-powder formula (4a, 6a), a matter of semantics is involved; the Orders had provided that the lower of the two formulae should determine the price, and the proposal to remove the butter-powder formula necessarily meant that the M-W Series would be left as the sole basis for pricing the milk.

As we have previously shown, the butter-powder formula was based upon the publicly-negotiated prices of those products on the Chicago Commodities Exchange. In the industry, that formula was called the "snubber",¹¹ a borrowed nautical term meaning in this instance that it served to prevent the secret M-W Series from running out of control.

11. This term was also used by the Court in its Opinion at p. 16.

When it was proposed to remove this restraining influence from the M-W Series, a more penetrating analysis of the Series' validity was appropriate, particularly in view of the increasing belief that the Series was subject to manipulation (348a, 573a-79a). It was for this reason that the Appellants and various other parties moved repeatedly for an Order directing the Secretary to come forward with information about the Series so that an open determination could be made on the propriety of requiring that Series as the sole basis for determining prices (142a-48a, 491a, 657a). The Secretary refused to do so (581a-91a).

We have previously referred to the Dwight Morris testimony in the Milk Monopolization Cases, that he had indeed rigged the M-W Series at the cost of millions of dollars to handlers, and ultimately consumers (page 16, supra). This testimony occurred after the rule-making hearing but before the final "long-term" Order. This was the very type of evidence which Appellants and others sought unsuccessfully to explore on the hearing record. Had the opportunity been permitted to allow the M-W Series to be analyzed on the record, this type of evidence might well have come out, raising serious questions about the proposals to base the price of all milk on the Series; the important point is, of course, that no such opportunity was ever given.

The decision of the Secretary to base prices on a secret formula known only to him involves precisely the same legal infirmities as decisions based upon non-record "expertise" purportedly held by him. The cases have uniformly held that administrative agencies -- including the Department of Agriculture -- may not base decisions on "expertise" privately held by administrators.

In passing the Agricultural Marketing Agreements Act, Congress made it clear that it was "not conferring untrammelled discretion on the Secretary and authorizing him to proceed in a vacuum:" Zuber v. Allen, 396 U.S. 168, 185, 90 S. Ct. 314, 324 (1969). See Brannan v. Stark, 342 U.S. 451, 469, 72 S. Ct. 433, 440 (1952); Blair v. Freeman, 370 F.2d 229, 235-236 (D.C. Cir. 1966). As the Supreme Court said in affirming the reversal of an I.C.C. Order:

"We agree with the District Court that there is no substantial evidence that territorial average costs are necessarily the same as the comparative costs incurred in handling North - South freight traffic. If we were to reverse the District Court, we would in effect be saying that the expertise of the Commission is so great that when it says that average territorial costs fairly represent the costs of North - South traffic, the controversy is at an end, even though the record does not reveal what the nature of that North - South traffic is. The requirement for administrative decisions based on substantial evidence and reasoned findings, which alone make effective judicial review possible, would become lost in the haze of so-called expertise. Administrative expertise would then be on its way to becoming "a monster which rules with no practical limits on its discretion.'" Burlington Truck Lines v. United States, 371 U.S. 156, 167. That is

impermissible under the Administrative Procedure Act." Baltimore & Ohio R. Co. v. Aberdeen & R.R. Co., 393 U.S. 87, 91-92, 83 S.Ct. 280, 283 (1968), reh. denied, 393 U.S. 1124 (1969).

We submit that the Baltimore & Ohio decision is directly analogous to this case; while the Secretary says the M-W Series is "good", the record does not reveal what it is.

The very purpose of a rule-making hearing is to buttress the Secretary's decision, not to provide a convenient cover for private action:

"The purpose of requiring the Government to produce evidence at a hearing is twofold. First, it will create an evidentiary record on which the Secretary can make his findings based on clear and rational choices. It allows a court to understand the basis for the Secretary's decision and intelligently rule on whether the decision is lawful and supported by substantial evidence."

"Secondly, to require the introduction of evidence by the government and force it to reveal publicly the facts which form the basis for the Secretary's decision allows interested parties to test, refute, rebut or buttress these facts. This is what a fact-finding hearing is all about. It is an educational process, not only for the Secretary, but also for the public, Congress and the courts so that ultimately the best decision is made. For the Secretary to hide the facts behind a facade of administrative expertise would be to frustrate the Congressional intent of the Agricultural Adjustment Act and the Administrative Procedure Act. The facts could then never be challenged, never tested. Ultimately, the absence of facts would result in incestuously perverting administrative integrity and public confidence in government." Abbotts Dairies Division of Fairmont Foods, Inc. v. Butz, 389 F. Supp. 1, 10-11 (E.D. Pa. 1975) (Emphasis added).

The District of Columbia Court of Appeals has said that administrative expertise is strengthened, not crippled by a

requirement of substantial evidence: Greater Boston Television Corp. v. FCC, 444 F.2d 841, 850 (D.C. Cir. 1970), cert. denied, 403 U.S. 923 (1971).

These principles have been regularly applied to proceedings under this Act. In Fairmont Foods Co. v. Hardin, 442 F.2d 762 (D.C. Cir. 1971), the Secretary of Agriculture had established by geographic area certain differentials on the price of milk paid to farmers. The facts did not support his action, but the Secretary contended that nonetheless his decision should be sustained so that market disruption would be precluded, and alignment of the Orders achieved -- precisely the grounds for the Secretary's action in this case. The Court of Appeals disagreed, saying that while administrative and executive expertise encompasses powers of analysis not possessed by others, such analysis "must be justified by reference to objective evidence." 442 F.2d at 772. Since the Court could not find a basis for the Secretary's findings "beyond mere speculation", the order was set aside: Ibid.

In Abbotts Dairies Div. of Fairmont Foods, Inc. v. Hardin, 351 F. Supp. 561 (E.D. Pa. 1972), the District Court invalidated a milk pricing order of the Secretary of Agriculture upon a finding that there was "no objective evidence to support its validity..." 351 F. Supp. at 566.

And in Abbotts Dairies v. Butz, supra, the Court held improper the action of the Secretary in issuing an emergency

order temporarily suspending a "bracketed" milk-pricing formula, and subsequently terminating without a hearing that portion of the order making it temporary.

The Court below found that the decision to use the M-W Series as the sole basis for pricing milk was supported by the need to "align" the Northeast Orders with other Orders if "market disruption" was to be avoided. (1464a-1465a, 1466a-1467a). The Court did not indicate what portion of the record evidence supported any need for alignment with other Orders; we know of none.

There are, indeed, other Milk Marketing Orders in which the sole price determinant is the M-W Series; but it should be noted that the Department's decision to use the M-W Series in the other markets was arrived at only the day before the hearing in the present case was convened (1204a-1205a). In that case, which was based on a hearing record three years old, the Department had reached a Recommended Decision to retain the butter-powder formula in those Orders which had it (1205a). The final decision -- announced the day before the hearing in the present case began -- reversed without notice the Recommended Decision (1205a). In fact, the Department refused to make available copies of the decision and Order in that case to the participants in this hearing, until after this hearing was concluded (1213a, 1216a-1217a). We should add that we are advised that the M-W Series was not examined in that hearing

record either; the participants in the present hearing were not parties to that case, which involved distant areas.

The Secretary has in the past sought to justify Order amendments on the need to "align" an Order with other Orders. This may be attributable to the fact that it is relatively easy for the Secretary to "find" in a fuzzy and generalized way that a particular price regulation serves the purposes of "alignment", whatever alignment is.

In Fairmont Foods Co. v. Hardin, supra, The Court reversed an Order based on such a rationale. The Court found that the record of the promulgation hearing did not support the findings of the Secretary either with respect to deficit zones or with respect to alignment with other markets. When the Secretary argued that he should be allowed to prevent disruption by misalignment before it actually occurred, the Court acknowledged his power to anticipate harm, but it insisted that there must be a rational basis of record even for invoking the concept of preventive remedy.

The Fairmont Court, citing Zuber v. Allen, 396 U.S. 168, 90 S.Ct. 314 (1969), stressed the limited scope of authority that Congress delegated to the Secretary in the field of milk-marketing regulations. When the Secretary in Zuber failed to advance sufficient justification for certain nearby differentials in terms of economic service to the handlers,

the Court concluded that they fell outside the scope of his authority and were therefore invalid. The Agricultural Marketing Agreements Act "does not contain a mandate phrased in broad and permissive terms" but rather a particularized scheme of explicit instructions from Congress to the agency. Zuber v. Allen, supra at 183.

See also Abbotts Dairies v. Butz, supra, where the Court again rejected an Order amendment based upon an alleged need to "align" Orders where no evidence supported the need for alignment.

We respectfully submit that the Court below erred in finding substantial evidence in this record of a need to align the Orders with the Orders issued the day before this hearing began. There is no evidence concerning those Orders or a need to align with them; indeed, as we have shown, the Orders and decisions were not even available to the participants in the present hearing at the time it took place.

The requirement that agency action be based upon the public record, and not upon information held in secret by agencies, is of historic and important significance in our law. It is simply not fair and equitable for an administrative agency to base findings and decisions on material not introduced on a hearing record where a hearing is required. The Supreme Court early applied this principle not only to adjudicatory proceedings but also to quasi-legislative proceedings where, as here,

Congress has required a hearing. In Morgan v. United States, 298 U.S. 468, 56 S.Ct. 906 (1936), the Court noted that the statutory requirement of a full hearing has obvious reference to the tradition of judicial proceedings, where nothing can be treated as evidence which has not been introduced as evidence. Similar conclusions have been reached under other statutes in both quasi-legislative and, of 'course, in quasi-judicial contests.

An Order establishing a price-setting formula that no one knows anything about except the agency which issued the Order, is invalid, and it is not made valid because persons may offer conclusory testimony supporting it when it is to their economic advantage to do so.

Furthermore, the adoption of a secret formula establishes a very bad precedent; what may be "good" today may turn out to be "bad" tomorrow, particularly when the long-run effects of a Rule of prospective application cannot be evaluated on the record, by those who question the wisdom of the Rule.

We submit that the Record in this case was insufficient to support the Order, and that the Court below erred in holding that it was.

CONCLUSION

For the reasons set forth above, we respectfully urge Your Honorable Court to reverse the decision of the Court below, vacate the 1974 Amendments to Order No. 2, and remand the case to the Secretary for further proceedings as provided by 7 U.S.C.A. §608c(15)(B).

Respectfully submitted,

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**COURT OF APPEALS
SECOND CIRCUIT**

**FRIENDSHIP DAIRIES, INC., POLLIO DAIRY
PRODUCTS CORP., CROWLEY FOODS INC.,
QUEENSBORO FARM PRODUCTS INC., SARATOGA
etc.,**

Plaintiffs-Appellants.,

**EARL BUTZ, SECreTary of the Deppartment of
Agriculture of the United States,
Defendant-Appellee,**

Index No.

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF

SS.:

I, James A. Steele being duly sworn, depose and say that deponent is not a party to the action,
is over 18 years of age and resides at 112 West 136th Street; New York, New York

That on the 15th day of Sept. 1977 at 1. 225 Cadman Plaza; Brooklyn, N.Y.
2. One Battery Park Plaza; N.Y., N.Y.

deponent served the annexed

**Appendix
Brief**

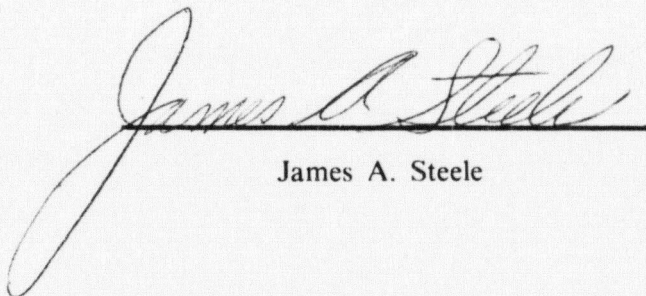
1. David Trager; U.S. Atty East Dist. ^{upon}
2. Roger Doering; o/o Simpson Thatcher &
Bartlett, Esqs

the in this action by delivering a true copy thereof to said individual
personally. Deponent knew the person so served to be the person mentioned and described in said
papers as the herein,

Sworn to before me, this 15th
day of Sept., 19 77



ROBERT T. BRIN
NOTARY PUBLIC, State of New York
No. 31-0418950
Qualified in New York County
Commission Expires March 30, 1979



James A. Steele

